IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

No. 11070.

BYRON C. HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 11071.

DAISY MAY HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

A. CALDER MACKAY and
ADAM Y. BENNION,
728 Pacific Mutual Building, Los Angeles 14,
Attorneys for Petitioners

Parker & Company, Law Printers, Los Angeles. Phone 20

TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

CASES. **PAGE**

Statutes.

TEXTBOOKS.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

No. 11070.

BYRON C. HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

No. 11071.

DAISY MAY HANNA,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

Preliminary Statement.

The above cases having been consolidated for the purpose of briefing and hearing, this brief is presented on behalf of the Petitioner in each of these cases.

Opinion Below.

The Memorandum Findings of Fact and Opinion of The Tax Court of the United States, entered January 15, 1945 (R. 21-26 in No. 11070 and R. 22-27 in No. 11071), are not reported.

Jurisdiction.

The Commissioner of Internal Revenue, Respondent herein, on November 17, 1942, mailed to each Petitioner a notice of deficiency wherein, so far as is material to these proceedings, the Respondent proposed additional income taxes for the calendar year 1940 in the sum of $4,134.55 for Byron C. Hanna and in the sum of $3,476.26 for Daisy May Hanna. (R. 11-16 in No. 11070 and R. 12-16 in No. 11071.) Within the ninety-day period each Petitioner filed a petition with The Tax Court of the United States wherein it was alleged, among other things, that Respondent's action in denying the application of Section 107 of the Internal Revenue Code to a fee received in 1940 by Petitioners as community income for legal services rendered over a period in excess of five years by the firm of Hanna and Morton, of which firm Bryon C. Hanna was a partner, which said action by Respondent gave rise to the asserted deficiencies in tax, was erroneous. The Petitioners prayed the Court to determine that no deficiencies existed for said calendar year 1940. (R. 4-19 in No. 11070 and R. 4-20 in No. 11071.) Issue was duly joined by Respondent's answer in each proceeding. (R. 19-20 in No. 11070 and R. 20-21 in No. 11071.)

Said petitions were filed pursuant to the provisions of Section 272(a) of the Internal Revenue Code.

The proceedings, duly consolidated for hearing and opinion, came on for hearing on April 27 and 28, 1944,

before Hon. Sam B. Hill, Judge of The Tax Court of the United States. (R. 41 in No. 11071.)

Thereafter, on January 15, 1945, the Court entered its Memorandum Findings of Fact and Opinion (R. 21-26 in No. 11070 and R. 22-27 in No. 11071), and on the same day entered decisions that there were deficiencies in income tax for the calendar year 1940 in the sum of $4,134.55 in the case of Bryon C. Hanna and in the sum of $3,476.26 in the case of Daisy May Hanna. (R. 26-27 in No. 11070 and R. 28 in No. 11071.)

Each Petitioner, on April 12, 1945, filed a petition for review by this honorable Court with the Clerk of The Tax Court of the United States (R. 27-37 in No. 11070 and R. 29-39 in No. 11071) and on April 13, 1945, served notice thereof on Respondent. (R. 38 in No. 11070 and R. 40 in No. 11071.) A statement of points to be relied upon was served upon Respondent and filed by each Petitioner on May 19, 1945. (R. 40-41 in No. 11070 and R. 122-123 in No. 11071.)

Both petitioners were and are residents of the County of Los Angeles, State of California, and as such filed their respective income tax returns with the Collector of Internal Revenue for the Sixth Collection District of the State of California. (R. 4 and 19 in No. 11070 and R. 4 and 20 in No. 11071.)

The petitions to this honorable Court were filed pursuant to the provisions of Section 1142 of the Internal Revenue Code and jurisdiction is invoked under Section 1141 of said Code.

Questions Involved.

The Tax Court held that Section 107 of the Internal Revenue Code, which is set forth in full hereinafter, could not be invoked by Petitioners. Said section provides a limitation upon the amount of tax attributable to compensation received for personal services rendered over at least a five-year period, where not less than 95 per centum of such compensation is paid only on completion of the services.

The Tax Court decided that the fee hereinabove mentioned was received for services rendered in litigation extending over a period from 1932 to 1940; and that the total fee for these services embraced the following items:

Advances to Hanna and Morton prior to 1940 from a trust fund held by Hanna and Morton for the payment of costs and expenses in connection with the litigation	$ 5,500.00
Interest on said trust funds which Hanna and Morton were permitted to take conditionally prior to 1940	1,168.86
Final fee received by Hanna and Morton in 1940	121,787.74
Total fee	$128,456.60

By this computation it appears that in 1940 Hanna and Morton received $246.03, less than 95% of the total fee, in that year; or, as stated by The Tax Court, only 94.8% of the total fee. Therefore, by this minute margin Petitioners are precluded from claiming the benefit of Section 107, I. R. C.; and accordingly must pay the assessed deficiency taxes above mentioned, aggregating $7,610.81.

We agree that the advances of $5,500.00 constituted a part of the total fee; but we contend that these advances did not constitute income to Hanna and Morton until 1940.

We further contend that the interest in the amount of $1,168.86 did not constitute any part of the fee or compensation for the services rendered, and that the conditional receipt thereof by Hanna and Morton prior to 1940 should be entirely disregarded in considering the application of Section 107, I. R. C.

To summarize: It is the contention of Petitioners that the fee consisted of the amount of $121,787.74 which The Tax Court states was received by Hanna and Morton in 1940, plus the trust fund advances in the amount of $5,500.00, the unconditional right to which was obtained by Hanna and Morton in 1940; or a total of $127,287.74; and that accordingly the Petitioners are properly entitled to receive the benefit of the provisions of Section 107, I. R. C.

The extraordinary conclusion of The Tax Court, by which a stated deficit of 1/5 of 1% of the total amount of the fee received in 1940 (amounting to $246.03) is accredited with the effect of depriving Petitioners of a benefit of the value of $7,610.81 to Petitioners, invites the studious attention of this Honorable Court to the facts involved and to pertinent principles of law.

The evidence on behalf of Petitioners was uncontroverted, and conclusively establishes the facts hereinafter set forth, to wit:

Statement of Facts.

(References are to names of witnesses and to transcript pages.)

1. At all times herein mentioned Byron C. Hanna and Daisy May Hanna were husband and wife, and residents of the State of California. [Hanna, 97.]

2. At all times herein mentioned Harold C. Morton and Byron C. Hanna were attorneys at law, engaged in the practice of law as equal co-partners, under the firm name and style of Hanna and Morton, in the City of Los Angeles, State of California. [Morton, 42; Hanna, 99.]

3. At all times herein mentioned Etienne Lang (hereinafter referred to as "Lang"), was the agent and attorney in fact of numerous members of a family of French citizens, herein referred to as "Lazards" [Morton, 42 and 58.]

4. In July, 1932, Lang, on behalf of Lazards, consulted Morton with regard to a claim of Lazards against the Anglo-California National Bank of San Francisco, Herbert Fleishhacker, its president, and certain other firms and individuals, arising out of certain acts of said Bank and Fleishhacker as the agents of the Lazards in the sale of certain property in California belonging to Lazards. [Morton, 42.]

At that time, Lang, on behalf of Lazards, employed Hanna and Morton for two specific purposes only:

(a) To render an opinion upon the validity of such claim; and

(b) To prepare a specimen form of complaint indicating the type of action that would be brought to recover on such claim. [Morton, 42.]

At that time Lang and Morton agreed that Hanna and Morton would be paid a fee of $2,500.00 for these particular services. [Morton, 43.]

Subsequently, on August 19, 1932, this sum of $2,500.00 was paid by Lang to Hanna and Morton. [Morton, 43; Petitioners' Exhibit 1, 43.]

5. It was distinctly understood between Lang and Morton that the $2,500.00 was in payment of the particular services rendered at that time. There was no obligation on the part of Lang or Lazards to employ Hanna and Morton for any further services, and no obligation on the part of Hanna and Morton to accept any such employment or to render any further services. Lang made it clear to Morton that Lazards might decide not to institute any suit and also if they did decide to institute a suit, they might select other counsel to represent them. [Morton, 54-55 and 59-60.]

6. The services involved in the employment hereinbefore mentioned were completed by the end of August, 1932, at which time a draft of the specimen complaint was delivered to Lang. [Morton, 60.] At that time Lang informed Morton that no definite decision had been made whether to file suit, or if so, whether to employ Hanna and Morton for such purpose. [Morton, 43.]

7. Lang again called upon Morton in October, 1932, and advised Morton that the Lazards had decided to file the suit; that he had investigated Hanna and Morton, and was authorized to employ this firm. [Morton, 43-44.]

8. At that time different bases of compensation for such employment were discussed. Morton told Lang that Hanna and Morton would take the case on a fifty-fifty basis and that Lazards would not be required to advance any money for expenses. [Morton, 62.]

Lang rejected this arrangement and suggested that the best possible estimate of the amount required for expenses be made; that Lazards advance such amount; and in consideration of this, the contingent compensation be substantially reduced. [Morton, 63.]

Finally Morton told Lang that Hanna and Morton would handle the case for a fee of fifteen per cent of the recovery, provided Lazards advanced an amount estimated to be sufficient to defray the costs and expenses of the litigation. [Morton, 44.]

At that time it was estimated that a very substantial amount would be required to defray the costs and expenses of the litigation on account of the necessity of investigating values of property in 1915 and 1917; canvassing long time residents in Kern County having knowledge of oil operations; the expense of taking depositions, including depositions of Lazards in Paris; and the expenses of one or more trips to Paris in that connection. [Morton, 55-56.]

9. Finally, Lang and Morton agreed that the amount of $27,500.00 should be advanced by Lazards to defray the costs and expenses of the litigation, with the understanding that if any balance should remain at the conclusion of the employment, it would belong to Hanna and Morton. [Morton, 44.]

Lang was insistent that the money be handled in such a manner that it would be used to defray the expenses; and Morton explained to Lang that the money would be treated as trust funds by Hanna and Morton, and told him that he would have access to the record of this trust account at all times. [Morton, 44.]

10. A written contract of employment was prepared by Morton on October 15, 1932. Lang initialed and subscribed his name to a copy of this contract, which is Petitioners' Exhibit 10. [Morton, 52-53.]

Another copy of this contract, which, with an immaterial variation is identical with Exhibit 10, was sent forward for signature by Lazards, and came back some months later. This is Petitioners' Exhibit 11. [Morton, 52-54.]

The provisions of Exhibits 10 and 11, in so far as pertinent to the present case, are as follows:

"Fees and Costs.

> The clients will pay to the attorneys the sum of Thirty Thousand Dollars ($30,000.00) and a contingent fee based on the amount of all sums or things of value recovered as a result of such suit (or suits) of 15% of the first million dollars recovered and 10% of all sums in excess of one million dollars, payable only when and as received by the clients and in the same money or things of value as are received by the clients. Of said $30,000.00 the attorneys have heretofore been paid $2,500.00, and the balance of $27,500.00 will be paid forthwith upon the execution of this agreement.
>
> The said attorneys agree that in consideration thereof they will bear and pay all expenses and costs of such suit or suits, including all appeals, and hold the clients harmless by reason thereof."

11. It will be observed that Exhibits 10 and 11 provide for the payment of $30,000.00 and recite the previous payment of $2,500.00. This language was inserted at Lang's request so that the contract would show the total

amount paid by him up to that time in connection with this matter. [Morton, 54; Hanna, 107.] The $2,500.00 item, however, which refers to the payment on August 19, 1932, had nothing to do with the services to be rendered and which were subsequently rendered under Exhibits 10 and 11. [Morton, 54-55; and 61.]

12. Pursuant to the provisions of Exhibits 10 and 11, on October 15, 1932, Lang paid to Hanna and Morton $27,500.00. The receipt for this payment is Petitioners' Exhibit 2, and contains the notation that it was received on "Trust acct." [Morton, 45.]

13. At all times herein mentioned Hanna and Morton kept daily financial records, showing receipts and disbursements. Whenever money was received for specific purposes it was designated as a "Trust." Each day a statement was prepared showing cash received and whether it was for trust account or the firm's own funds. The daily statement contained the expenditures for the day, showing whether it was from the firm's own funds or from the trust account, and showing the balance of trust obligations; the balance in the bank; and the net amount which belonged to the firm of Hanna and Morton. [Hanna, 97-98.]

14. The daily financial reports for October 14th, 15th, and 17th, 1932, Petitioners' Exhibit 4, show that on October 14, 1932, the trust fund amounted to $543.04; that on October 15, 1932, $27,500.00 was received and placed in trust; and that the balance of the trust fund, after the receipt of this money and payments against the trust fund, was $26,043.04. [Morton, 47-48.]

15. The amount of $17,500.00 was entered as a credit to an account entitled "Lazard Matter, Trust Account,"

Petitioners' Exhibit 5 [Morton, 49-50]; and the control trust account ledger sheet, Exhibit 8, showed the receipt of the amount of $27,500.00 in trust on October 15, 1932. [Morton, 51-52.]

16. The trust funds, including the money in question, were segregated at all times on the books of Hanna and Morton, but the funds were carried in general bank accounts of the firm. [Hanna, 101.] The funds herein referred to were treated as trust funds and regarded as trust funds at all times. [Hanna, 106.]

The amounts kept in the various bank accounts of Hanna and Morton at all times during this period equaled or exceeded the aggregate amount of the balance of their trust accounts. [Hanna, 98.]

Lang had access to the Lazard Matter Trust Account and frequently examined it for the purpose of noting expenditures from these funds and the balance on hand. [Morton, 45, 64, and 66.]

17. At the time the $27,500.00 was received, Morton told Lang that Hanna and Morton would like to withdraw $5,000.00 from the trust because they would be expending time, and also incurring expenses in connection with the litigation, which would not appear on the account as charges. Lang agreed at that time that they might each withdraw $1,000.00 from the account, with the understanding that if it were necessary, this money would be restored to the account. [Morton, 49.]

Accordingly, on the same date a check was issued to Morton for $1,000.00 and also to Hanna for $1,000.00; and these withdrawals appear on the daily financial report of October 15, 1932, Petitioners' Exhibit 4, and also on the ledger sheet of the Lazard Matter Trust Account,

Petitioners' Exhibit 5, and on the ledger sheet of the Trust Control Account, Petitioners' Exhibit 8, as debits against the trust account of that day. [Morton, 49-51.]

18. In the latter part of the month of October, 1932, Morton requested Lang to allow Hanna and Morton to withdraw an additional $1,500.00 from the trust account, and Lang consented to this, also upon the condition that if it became necessary, the moneys withdrawn would be restored to the account. [Morton, 49.] This withdrawal also appears as a debit against the Lazard Matter Trust Account, Petitioners' Exhibit 5, on October 31, 1932. [Morton, 50.]

19. Thereafter, on May 1, 1933, with Lang's consent and upon the same conditions, Hanna and Morton withdrew $1,000.00 from the account. [Morton, 50.] This withdrawal appears on Exhibit 6, which is a continuation of the Lazard Matter Trust Account. [Morton, 50.]

20. Subsequently, on October 31, 1936, with Lang's consent, and under the same conditions, Hanna and Morton again withdrew an additional amount of $1,000.00 from the trust account. [Morton, 50.] This withdrawal appears on Petitioners' Exhibit 7, which is a continuation of the Lazard Matter Trust Account. [Morton, 50.]

21. The foregoing advances of Hanna and Morton from the trust account are tabulated as follows:

October 15, 1932	$ 2,000.00
October 31, 1932	1,500.00
May 31, 1933	1,000.00
October 31, 1936	1,000.00
Total	$ 5,500.00

22. Soon after the $27,500.00 was received, Hanna and Morton placed $10,000.00 of these funds in a savings account with the Security-First National Bank of Los Angeles, a transcript of which account was introduced in evidence as Respondent's Exhibit A; and $10,000.00 in a savings account with the Bank of America National Trust and Savings Association, a transcript of which account was introduced in evidence as Respondent's Exhibit B. [Morton, 67-70.]

Lang was advised of the deposit of this money in these savings accounts, and approved of the idea. [Morton, 71 and 72.]

Interest accrued on these savings accounts in the aggregate amount of $1,168.86. [Morton, 69-70.] The interest was discussed with Lang, and Lang said that Hanna and Morton could keep the interest if they would put it back if necessary to complete the payment of expenses. [Morton, 71, 72.]

23. The interest was withdrawn as follows:

Year	Security-First National Bank	Bank of America
1934		$265.93
1935	$676.68	
1936	$226.25	

24. The litigation against the Anglo-California National Bank of San Francisco and Herbert Fleishhacker was brought to a successful conclusion, and the judgment was paid on January 19, 1940.

At that time Hanna and Morton received the fifteen per cent contingent fee provided by Exhibits 10 and 11, amounting to $111,588.84; reimbursement from the defendants for costs expended out of the trust fund, amount-

ing to $2,429.35; plus the balance in the trust fund, amounting to $7,769.55; a total of $121,787.74. [Hanna, 97; Lyons, 119.]

This total amount was included in the Hanna and Morton Partnership Return of Income for the calendar year 1940. [Lyons, 119.]

Byron C. Hanna and Daisy May Hanna, in making their returns of community income, respectively, for the year 1940, each elected to invoke the benefit of Section 107 of the Internal Revenue Code and to spread their respective portions of the Lazard fee over a period of five years, Petitioners' Exhibits 13 and 14. [111 and 115.]

Statement of Points Relied Upon.

1. The Tax Court of the United States erred in finding as a fact or deciding as a matter of law that the withdrawals from the $27,500.00 trust fund mentioned in the Findings, amounting to $5,500.00, constituted payment of a part of the fee for the services rendered in the employment mentioned in the Finding, to Hanna and Morton when and as received by Hanna and Morton;

2. The Tax Court of the United States erred in finding as a fact or deciding as a matter of law that the withdrawal of accrued interest on the said trust fund, amounting to $1,168.86, constituted payment of a part of the fee for the services rendered in the said employment to Hanna and Morton when and as received by Hanna and Morton; and

3. The Tax Court of the United States erred in determining that less than 95% of the fee of Hanna and Morton for services under the employment above mentioned was received in the calendar year 1940.

ARGUMENT.

If the decision of The Tax Court that the conditional advances from the trust fund, aggregating $5,500.00, and the interest on the trust fund, amounting to $1,168.86, constituted fees received by Hanna and Morton during the years 1932 through 1936 in connection with the employment in question, be regarded as a finding of fact, it is contrary to the uncontroverted evidence; and therefore such decision may be properly reviewed by this Honorable Court.

If this portion of the decision of The Tax Court be regarded as a conclusion of law, then it is also a proper subject of review by this Honorable Court.

Bogardus v. Commissioner, 302 U. S. 34, 58 S. Ct. 61, 82 L. Ed. 32;

Dobson v. Commissioner, 320 U. S. 489, 64 S. Ct. 239, 88 L. Ed. 248 (88 L. Ed. Adv. Ops. 179);

Commissioner v. Scottish American Investment Co., 89 L. Ed. Adv. Ops. p. 97 (Dec. 4, 1944);

Claridge Apts. Co. v. Commissioner of Internal Revenue, 89 L. Ed. Adv. Ops. 137 (Dec. 4, 1944).

Applicable Law.

Section 107, I. R. C., provides:

> "In the case of *compensation (a) received for personal services* rendered by an individual in his individual capacity, or as a member of a partnership, and covering a period of five calendar years or more from the beginning to the completion of such services, (b) paid (or not less than 95 per centum of which is paid) only on completion of such services,

and (c) required to be included in gross income of such individual for any taxable year beginning after December 31, 1938, the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period." (Emphasis supplied.)

Purpose and Intent of Section 107, I. R. C.

By subsequent declaration and amendment, Congress has manifested a liberal attitude and intent in the enactment of this legislation for the purpose of ameliorating the manifest injustice to which it was directed. The Senate Finance Committee, in commenting on Section 220 of the 1939 Act, explained the purpose and intent of this legislation as follows:

> "It has been considered a hardship to tax fully the compensation of writers, inventors, and others who work for long periods of time without pay and then receive their full compensation upon the completion of their undertaking. Under existing law, such persons have their income for the whole period aggregated into the final year. This results in two inequities: First, only the deductions, expenses, and credits of the final year are chargeable against the compensation for the full period; second, under our graduated surtax, the taxpayer is subjected to a considerably greater burden because of the aggregation of his compensation."

In decisions applying the provisions of this section, the courts have uniformly manifested a liberal attitude.

In *Keeble v. Commissioner*, 2 T. C. 1249, at page 1252 The Tax Court said, of the above statute:

> "* * * The statute is remedial, granting relief to those coming within its terms. A remedial statute should be given a rational, sensible construction and one which will 'give the relief it was intended to provide.' *Bonwit Teller & Co. v. United States*, 283 U. S. 258; *F. Harold Johnston, Executor*, 33 B. T. A. 551; *Michel J. A. Bertin*, 1 T. C. 355. 'Common sense interpretation is the safest rule to follow in the administration of income tax laws,' *Rhodes v. Commissioner*, 100 Fed. (2d) 966; and 'a desire for equality among taxpayers is to be attributed to Congress, rather than the reverse,' *Colgate-Palm Olive-Peet Co.*, 320 U. S. 422. 'All statutes must be construed in the light of their purpose. A literal reading of them which would lead to absurd results is to be avoided when they can be given a reasonable application consistent with their words and with the legislative purpose.' *Haggar Co. v. Helvering*, 308 U. S. 389; *Helvering v. New York Trust Co.*, 292 U. S. 455; *Musselman Hub-Brake Co. v. Commissioner*, 139 Fed. (2d) 65 (C. C. A., 6th Cir., Dec. 1, 1943). * * *"

At pages 1253-4, it was further stated:

> "One other circumstance has inclined us to the view which we have taken. The section was amended by section 139 of the Revenue Act of 1942. The amendment is not applicable to the compensation received by these petitioners; but it is worthy of note

that it was made to liberalize, rather than to restrict, the application of the principle of taxing income at the rates applicable when earned. In the new act the period from the beginning to the completion of the services is expressed in months rather than in calendar years and the period is reduced—prospectively—to 36 calendar months. Congress recognized that the use of the expression 'calendar year' in the earlier legislation had resulted 'in an inequitable limitation of the scope' of the section and therefore it was eliminated. The new legislation had no effect upon the former and it does not cover the compensation received by these petitioners. It is nevertheless some slight indication that the Congress may not have intended that the term used by it should be applied and interpreted so as to bring about an inequitable result."

In *Slee v. Commissioner,* Docket No. 76, a Memorandum Opinion was rendered by The Tax Court on July 8, 1943. In that case the taxpayer, an officer of one of an affiliated group of companies, received in 1940 compensation in the amount of $24,000.00 for special services rendered over a period of more than five years, and which compensation was in addition to his regular salary during that period. It was held that he might properly avail himself of the provisions of Section 107, I. R. C.

In *Addition v. Commissioner,* 3 T. C. 427, the Commissioner contended that a member of the liquidating committee of a bank who was paid in 1940 for all services

from the time of his appointment in 1931, could not avail himself of the provisions of Section 107, I. R. C., for the reason that the work to be done by the committee of which he was a member had not been completed.

The Tax Court rejected this contention of the Commissioner, and held that the services for which the compensation was paid had been completed and that therefore the taxpayer was entitled to avail himself of the provisions of this section.

In *Smith v. Commissioner,* 3 T. C. 696, the Commissioner contended that the five year period referred to in Section 107, I. R. C., meant a calendar year extending from January 1st to December 31st, and that therefore the taxpayer could not obtain the benefit of this section under the facts presented in that case.

The Tax Court held that the words "calendar year" did not necessarily mean a year commencing on January 1st and ending on December 31st, and accordingly rejected the contention of the Commissioner and held that the taxpayer might secure the benefit of this section.

In *Slough v. Commissioner,* 147 F. (2d) 836 (C. C. A. 6), the Commissioner contended that ninety-five per cent of the compensation must be paid in one year to entitle the taxpayer to the benefit of Section 107, I. R. C.

The Court rejected this contention and held that the ninety-five per cent of the compensation need not be paid in one year.

In the course of the opinion, at page 837, the Court referred to the report of the Senate Finance Committee, hereinbefore quoted, and the Court said, at page 839:

> "It is true that the Supreme Court has said, as contended by the Commissioner, that provisions granting special tax exemptions are to be strictly construed; that exemptions are allowed only as a matter of legislative grace; and that a taxpayer seeking a deduction must show that he comes within the terms of an applicable statute. Helvering v. Northwest Steel Mills, 311 U. S. 46, 49, 61 S. Ct. 109, 85 L. Ed. 29; White v. United States, 305 U. S. 281, 292, 59 S. Ct. 179, 83 L. Ed. 172; New Colonial Ice Co. v. Helvering, 292 U. S. 435, 440, 54 S. Ct. 788, 78 L. Ed. 1348. But it is also true that the Supreme Court has said that a tax law 'is to be construed liberally in favor of the taxpayers to give the relief it was intended to provide' (Bonwit Teller & Co. v. United States, 283 U. S. 258, 263, 51 S. Ct. 395, 397, 75 L. Ed. 1018); and that 'if the words [of a tax statute] are doubtful, the doubt must be resolved against the government and in favor of the taxpayer.' United States v. Merriam, 263 U. S. 179, 188, 44 S. Ct. 69, 71, 68 L. Ed. 240, 29 A. L. R. 1547. See to the same effect Gould v. Gould, 245 U. S. 151, 153, 38 S. Ct. 53, 62 L. Ed. 211.
>
> In Colgate-Palmolive-Peet Co. v. United States, 320 U. S. 422, 425, 429, 64 S. Ct. 227, the statement was made that a desire for equality among taxpayers, rather than the reverse, is to be attributed to Congress. * * *"

The $27,500.00 Received by Hanna and Morton on October 15, 1932, Did Not Become Compensation "Received for Personal Services" Until the Trust Obligations Had Been Discharged, Which Did Not Occur Until January 19, 1940.

As a general rule, the income tax law is concerned only with realized gains and realized losses.

Weiss v. Weiner, 279 U. S. 333, 335, 73 L. Ed. 720, 721;

Lucas v. American Code Co., 280 U. S. 445, 74 L. Ed. 538;

Commissioner v. Darnell, Inc., 60 F. (2d) 82.

An important case, directly in point, and identical in principle with the facts in the present proceeding, is the case of *Taylor v. Commissioner,* 34 B. T. A. 347, 89 F. (2d) 465, 19 A. F. T. R. 378 (C. C. A. 7, March 26, 1937), wherein it appeared that the petitioners and their wives owned all of the stock of Transcontinental Freight Company outstanding in May, 1925. At that time they sold all of such stock to the Baldwin Universal Company. At about the same time, petitioners entered into a contract with Transcontinental Freight Company, whereby the freight company transferred to petitioners United States bonds of the par value of $145,000.00; and the petitioners agreed to assume and pay all additional income and excess profits taxes ultimately found to be due from the freight company for the years 1917 to 1924, inclusive, excepting unpaid installments of 1924 taxes shown on the original returns of the company; and further agreed to hold the company harmless and indemnify it against all expense for attorneys' fees in connection with the adjustment of such taxes. The freight company re-

linquished all right to receive back any part of the bonds in case the tax liability was settled for less than $145,000.00. Petitioners, who filed their income tax returns on a cash receipts and disbursements basis, did not report any part of the $145,000.00 in their incomes for 1925. A Revenue Agent included it, and the petitioners protested its inclusion, and their protest was allowed by the Commissioner. In the final settlement of their tax liabilities for 1925, no part of the $145,000.00 was included in their income.

Subsequently, the Commissioner, in determining the deficiencies of petitioners for 1929, included the $145,000.00, less certain expenses paid as attorneys' fees. Each petitioner then claimed that one-half of the $145,000.00 was income to him in 1925.

Both the Board of Tax Appeals and the Circuit Court of Appeals held that the income was properly assessed to petitioners in 1929. The Board of Tax Appeals said (pp. 349, 350):

> "* * * Although the petitioners received the Liberty bonds in 1925, they did not realize a gain of $145,000.00 in 1925 from the transaction because the transaction was only then beginning, and it was apparent at that time that they would have to make some expenditures which might even exhaust the entire amount which they had received. Until the tax liability was settled and their expenses determined, no one could say whether they had had a gain or a loss. The transaction was incomplete for tax purposes until 1929, when the tax liability which they had agreed to settle was finally settled and their expenses of litigation paid. Then for the first time their gain on the transaction could be computed by deducting their expenditures from their receipts. * * *."

The Circuit Court of Appeals said (p. 468):

> "We conclude that 1925 was not the proper year for the inclusion of value of these bonds. Stoner v. Commissioner (C. C. A.) 79 F. 2d 75; Commissioner v. Cleveland Trinidad Paving Co. (C. C. A.) 62 F. 2d 85; Lucas v. American Code Co., 280 U. S. 445, 50 S. Ct. 202, 74 L. Ed. 538, 67 A. L. R. 1010; North American Oil Consol. v. Burnet, 286 U. S. 417, 52 S. Ct. 613, 76 L. Ed. 1197.
>
> Petitioners' entire argument is based upon the fact that they acquired physical possession of $145,000 of Liberty Bonds *in 1925*. They seemingly overlook the fact that this was but the first step in a business transaction; that the second step in said transaction was an adjudication and payment of the tax against T. F. Co. When that tax was determined and paid, the transaction was completed. The profit was then certain. This was in 1929."

Applying the principle declared in the foregoing authorities, it is obvious that when the sum of $27,500.00 was paid to Hanna and Morton in October, 1932, this was but the first step in a business transaction. The second step in the transaction was to ascertain the amount of money to be expended for costs by Hanna and Morton. This could not be ascertained until the conclusion of the employment, in 1940. Then and then only could it be determined that any part of the $27,500.00 was to assume the character of compensation. When the litigation was concluded, and the amount of expenditures for costs was definitely known, then and then only, the transaction was completed. At that time, and not until that time, the profit or compensation was certain. That was in 1940.

Another important case is that of *Stoner v. Commissioner,* 79 F. (2d) 75 (C. C. A. 3), in which it appears that Stoner sold certain stock and agreed to deposit, and did deposit, $50,000.00 of the purchase price, and maintained the same on deposit for the term of two years to meet certain obligations specified in the contract of sale. No part of the money was used for such purpose, and at the end of the two year period, on June 1, 1931, the $50,000.00 was withdrawn from this special deposit.

The Court held that the taxpayer's share of this fund was not income to the taxpayer for the year 1929, in which it was received and in which the deposit was made, but was income in the year 1931 in which it was withdrawn. The Court said, at page 76:

> "Generally speaking, the Income Tax Law is concerned only with realized gains. Lucas v. American Code Company, supra. There was no receipt of his share of the fund by the taxpayer in 1929 as realized gain. He was acting in a fiduciary capacity for the group of shareholders in the Suburban Company, among whom he himself was one. He received the purchase price in that capacity and under the terms of the contract whereby it was received, he agreed as 'Seller,' to deduct the $50,000 fund, deposit it in a special account, and maintain it intact for two years except for such withdrawals as were necessary to carry out the purposes of indemnification. Thus, Stoner, as an individual taxpayer, did not receive his share of the fund until 1931, or have any right to it, any more than the several other shareholders of the Suburban Company represented by him. There could be no realized gain in the fund by any of the shareholders until 1931 * * *."

In the case of *Preston v. Commissioner,* 35 U. S. B. T. A. 312, it appears that two attorneys performed services for clients and received a check in payment therefor payable to the order of both; that they could not agree to the amount to which each was entitled; and the check was deposited in a bank to the joint account of both, and there was drawn from the joint account during the taxable year such amount only as each conceded the other entitled to, the balance being held to be drawn upon on settlement of the differences between them.

It was held that each attorney was required to report as income only the cash withdrawn for his separate use during the year. The Board of Tax Appeals said, at page 321:

> "In the last named case, and in numerous others cited by the respondent, the Board has held that where a taxpayer actually received money or property under a claim of right the taxpayer is liable to income tax upon the amounts received even though at a later date a portion of the money had to be refunded. Those cases are, however, distinguishable from the one at bar. The facts in this case are clear that Preston did not have the use and enjoyment in 1930 of any portion of the check received and made payable to Preston and Peck except to the amount of $100,000 * * *."

Applying the same reasoning to the case at bar, it must be acknowledged that Hanna and Morton did not have the use or enjoyment of any part of the sum of $27,500.00 paid on October 15, 1932, except possibly $5,500.00 withdrawn therefrom with the consent of the client, until

January 19, 1940. Even as to this latter amount they were under obligation to replace it should the expenses exceed the amount retained in the trust.

Another important case in point is *Madigan v. Commissioner*, 43 B. T. A. 549. In that case it appears that a football coach was employed for a fixed salary plus a percentage of certain receipts which could not be determined until an accounting in the following year. In the tax year he received a check from his employer with the express understanding that he hold the amount in trust until after the accounting for the tax year could be completed.

It was held that the petitioner was not required to report the check so received as income in the tax year. In the course of the decision, the Board of Tax Appeals said, at page 551:

> "* * * No one could tell until after the 1936 accounting whether petitioner would be entitled to any commission for the season, and certainly not what the amount, if any, would be. Prior to the accounting determination of the amount, petitioner had and claimed no right to use or enjoy any of the check except the amount of his 1934 and 1935 commissions which had been fixed and determined. This much he returned for tax in his 1936 income. The Commissioner was in error in adding any additional amount of the Fordham check. *Sara R. Preston*, 35 B. T. A. 312; *cf. North American Oil Consolidated v. Burnet*, 286 U. S. 417; *Doyle v. Commissioner*, 110 Fed. (2d) 157; certiorari denied, 311 U. S. 658; *Commissioner v. Alamitos Land Co.*, 112 Fed. (2d) 648."

Advances From the Trust Funds Were Not Compensation "Received for Personal Services."

The undisputed evidence discloses that the advances from the trust funds, aggregating $5,500.00, were loans which Hanna and Morton were under the obligation of returning to the trust fund if and when occasion arose.

Compensation "received for personal services," in the ordinary use of the terminology, means something paid unconditionally as a salary or wage or fee for personal services rendered.

These advances were not of this character. It is plain from the choice of the language used by Congress, "compensation received for personal services", that it was not intended or contemplated that conditional advances of this type should be classified as compensation, and that the acceptance thereof should deprive the taxpayer of the benefit of the undisputed purpose and intent of this legislation.

These advances do not come within the letter of the statute. Even if they did, they are not within the intent of the statute. Facts which, although within the letter of the statute are not within the intent or purpose of the legislation, should not be treated as subject to the statute.

In *Knight Newspapers v. Commissioner,* 143 F. (2d) 1007 (C. C. A. 6), the Court had occasion to consider the question as to whether certain income received by a corporation subject to a contingent obligation to repay the same, should be classified as income of the corporation within the terms of the Personal Holding Companies Act. The Court said, at page 1009:

> "Since the decision in North American Oil Consolidated v. Burnet, 286 U. S. 417, 424, 52 S. Ct.

613, 615, 76 L. Ed. 1197, it has been thought to be the rule that 'if a taxpayer receives earnings under a claim of right without restriction as to its disposition, he has received income which he is required to return (for tax purposes), even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent' * * *."

After discussing additional cases involving the same principle, the Court further said, at page 1010:

"*The cases cited, however, deal with the incidence of the general income tax, and it has been pointed out that no great injustice results in regarding tentative or contingent gains as income when received, since, if repayment is subsequently required, allowable deductions in a later year would roughly recompense the taxpayer for the tax paid in an earlier year.* Here, however, a surtax of some 65 to 75% is involved, and this cannot be recovered by a deduction for loss claimed in a subsequent year, since tax saving would then be limited by application only of the normal income tax rate. The personal holding company surtax is not, it is urged, a true tax, but a penalty. Its purpose is to force distribution of profits by a corporation so that they will be subject to taxation as income of shareholders. This has been noted in many cases, including General Securities Co. v. Commissioner, 10 Cir., 123 F. 2d 192; Pembroke Realty & Securities Corp. v. Commissioner, 2 Cir., 122 F. 2d 252. So, it is insisted, the rule of the Burnet case is not applicable, and even if the statute covers such income, it certainly was not within the intention of the Congress to treat contingent gains as income subjecting a holding company, not organized for tax evasion purposes, to the severe penalties

of the Act. Administrative necessity does not require such onerous result. *It is within the power of the court to declare a thing which is within the letter of the statute, not governed by the statute, because not within its spirit or the intention of its makers.* Pembroke Realty & Securities Co. v. Commissioner, supra; Holy Trinity Church v. United States, 143 U. S. 457, 12 S. Ct. 511, 36 L. Ed. 226; Gregory v. Helvering, 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596, 97 A. L. R. 1355." (Emphasis supplied.)

The Sum of $1,168.86, Interest on the Savings Accounts, Did Not Constitute Compensation "Received for Personal Services."

The interest received on the savings bank accounts clearly was not compensation "received for personal services" within the intent, purpose or language of Section 107, I. R. C. The interest is broadly distinguished from the character of compensation described in this section, for it was not any part of the compensation contracted to be paid for the services to be rendered.

The compensation for the personal services rendered in the employment in question was definitely fixed by the terms of the written contract of which Exhibits 10 and 11 are copies. It was definitely limited to a contingent fee of a percentage of the amount of the recovery, plus the balance, if any, which might remain in the trust fund. The interest was no part of that compensation.

If the receipt or retention of this interest by Hanna and Morton had been challenged, they could not have defended the right to receive or retain this interest in any court in the land on the theory that it constituted compen-

sation or a part of the compensation for the services rendered in this litigation. They had entered into contracts [Exhibits 10 and 11], definitely fixing the compensation they were to receive for rendering these services. Any payment in addition to that for which they had thus contracted would have been purely gratuitous as a matter of law.

The word "compensation" as used in Section 107, I. R. C., is legally equivalent to "consideration." It is elementary that where parties have agreed to perform services for a definitely specified consideration, any additional inducement to the parties to perform the services, whether by payment of money or otherwise, is wholly gratuitous.

The permission given to Hanna and Morton to receive this interest was in the nature of a loan at the time of the transactions, for it was subject to the obligation of repayment if it became necessary for the payment of costs and expenses.

When the case was finally concluded in 1940 and that possibility no longer existed, the interest became a gratuity from the Lazards to Hanna and Morton.

If it were necessary to be so specific, it might be logically argued that the interest was an emolument or an honorarium. The purposes of this case do not require that the interest be characterized with perfect exactitude. This much is certain. Upon the facts and under the law, it was not "compensation received for personal services."

In cases where the courts have had occasion to consider whether such incidental financial benefits were to be classified as compensation, it has been uniformly held that they are not to be so classified. Thus, it has been held that the word "emoluments" has a broader meaning than the

word "fees," which are defined as a reward or wages given to one as a recompense for his labor and trouble for the execution of his office or profession. *State v. Dishman*, 334 Mo. 874, 68 S. W. (2d) 797, 798.

Likewise, it has been uniformly ruled that commutations, allowances for quarters, lump sum subsistence allowances, lump sum allowances for uniforms and equipment and lump sum allowances for traveling expenses made to officers of the armed forces do not constitute income. (See Regulations 111, Sec. 29.22(a)-3, par. 7704, Prentice-Hall Service, 1945; also various bulletins listed in par. 7730, Prentice Hall-Service, 1945; also, *Jones v. United States,* 60 Ct. Cl. 552, 5 A. F. T. R. 5297, and *Sherburne's Case,* 16 Ct. Cl. 491.)

In *United States v. Smith,* 158 U. S. 346, at p. 348, 39 L. ed. 1011, at p. 1012, the Court said:

> "* * * The allowance of mileage to officers of the United States, particularly in the military and naval service, when traveling in the service of the government, is fixed at an arbitrary sum, not only on account of the difficulty of auditing the petty items which constitute the bulk of traveling expenses, but for the reason that officers travel in different styles, and expenses, which in one case might seem entirely reasonable, might in another be deemed to be unreasonable. There are different standards of traveling as of living, and while the mileage in one case may more than cover the actual expenses, in another it may fall short of it. It would be obviously unjust to allow one officer a certain sum for traveling from New York to Chicago, and another double that sum, and yet their actual expenses may differ as widely as that. *The object of the statute is to fix a certain allowance, out of which the officer may make a saving*

*or not as he chooses, or is able. And while, in some cases, it may operate as a compensation, it is not so intended, and is not a fee, charge, or emolument of his office within the meaning of section 834 * * *.*" (Emphasis supplied.)

Thus, it has been held that the appropriation of a lump sum to defray the personal expenses of a public official does not constitute additional compensation to the public official.

State v. Yelle, 7 Wash. (2d) 443, 110 P. (2d) 162;

Kirkwood v. Soto, 87 Cal. 394, 25 Pac. 488;

Milwaukee County v. Halsey, 149 Wis. 82, 136 N. W. 139;

Cummings v. Smith, 368 Ill. 94, 13 N. E. (2d) 69;

McCoy v. Handlin, 35 S. D. 487, 153 N. W. 361, L. R. A. 1915E, 858, Ann. Cas. 1917A, 1046;

Macon County v. Williams, 284 Mo. 447, 224 S. W. 835;

State v. Reeves, 44 S. D. 568, 184 N. W. 993;

Smith v. Jackson, 241 Fed. 747 (C. C. A. 5); 246 U. S. 388, 38 S. Ct. 353, 62 L. ed. 788.

This principle has been extended to appropriations providing for the entertainment of public officials and for wines, liquors and cigars furnished to public officials. *Russ v. Commonwealth,* 210 Pa. 544, 60 Atl. 169, 105 A. S. R. 825.

It has been held that a residence furnished to a sheriff is not a part of his compensation within the terms of the Corrupt Practices Act. *Kommers v. Palagi,* 111 Mont. 293, 108 P. (2d) 208.

In *Morrow v. Orshel Bros. Truck Lines,* 235 Mo. App. 1166, 151 S. W. (2d) 138, it was held that the act of an employer in allowing an employee the gratuitous use of the employer's automobile for the employee's own convenience, was a gratuity and did not constitute a part of the compensation of the employee. The Court said:

> "The Commission found that claimant's annual salary did not exceed the sum of $3600. Claimant testified that his salary was $3600 per year, but on cross-examination he said that he was furnished the automobile not only in connection with the business, but that he was permitted to use it for his own convenience. There is nothing in the evidence to show that the employer could not have withdrawn that use at any time it saw fit, and that its use was anything more than a gratuity extended by the employer to the employee, which could have been terminated at any time. If it was such it could not be considered as any part of his compensation. See Russell v. Ely & Walker Dry Goods Co., 332 Mo. 645, 60 S. W. 2d 44, 87 A. L. R. 953. * * *."

It has been held that interest collected by a United States District Court Clerk on funds in his custody, is not a part of the emoluments of his office.

United States v. MacMillan, 209 Fed. 266 (D. C. N. D. Ill., E. D.);

United States v. MacMillan, 251 Fed. 55 (C. C. A. 7);

United States v. MacMillan, 253 U. S. 195, 40 S. Ct. 540, 64 L. ed. 857.

In *Bogardus v. Commissioner,* 302 U. S. 34, 58 S. Ct. 61, 82 L. ed. 32, it was held that sums of money paid by a corporation, which had been formed by the stockholders of another corporation, to acquire certain assets of such other corporation, in contemplation of the sale of its entire stock to a third corporation; to employees, former employees, and a relative of a deceased employee of the second corporation, in recognition of the loyal support which had helped to make the undertaking a success; are gifts, although designated as an "honorarium" and as a "bonus * * * in recognition of the valuable and loyal services."

In the course of its decision, the Supreme Court said, 302 U. S. 34, 42; 82 L. ed. 32, 38:

> "Because the Unopco stockholders had benefited by the past services of the recipients, it by no means follows that the distribution in question was not a gratuity. It nowhere appears in the record that full compensation had not been made for these services. There would seem to be a natural inference to the contrary; and the inference is made determinate by the stipulated fact that no one was under any obligation, legal or otherwise (and this would include a moral obligation, however slight) 'to pay any additional compensation.' There is no ground for saying that the benefit received and the compensation then paid for it were not equivalents."

In *Siegel v. Commissioner,* 39 B. T. A. 60, it appeared that a law firm had rendered certain services in connection with the acquisition by a client of a large block of stock in a corporation. The law firm was paid $50,000.00 for its services, and was given an option to acquire 5,000

shares of the stock involved in the transaction at an advantageous price.

It was claimed by the Commissioner that the option to purchase this stock at such price was additional compensation to the law firm. The Board of Tax Appeals held that this was not correct, stating, at page 66:

> "Testing the facts of record by the criteria thus laid down, it is clear that the transfer of the option was in every sense a gift. It was so specifically characterized by both parties. Compensation in the full amount agreed on had been paid. It came as a surprise to petitioner and was conceived and suggested by the donor. On receipt by petitioner it was gratuitously apportioned by him among certain of his associates but not in the ratio of participation and ownership in the firm business. The only premises on which respondent's case is based are the fact that the relationship of attorney and client had existed, the coincidence in time with the payment of fees, and the further fact that the assignment was inspired by appreciation of valuable services rendered. But the Supreme Court has indicated clearly that these circumstances are not sufficient to defeat a gift if in fact a gift is intended and carried out."

In the recent case of *McDermott v. Commissioner,* ..... F. (2d) ..... (June 18, 1945), the United States Court of Appeals for the District of Columbia reversed The Tax Court's determination that the Ross Essay Prize awarded by the American Bar Association constituted taxable income to the recipient, holding that the award was not paid for services rendered but was a gift.

In *Chase v. Commissioner,* 19 B. T. A. 1040, it appeared that petitioner was the sister of George Chase,

who had been Dean of the New York Law School, and to whom the said school was indebted at the time of his death in th eamount of approximately $29,000.00. This indebtedness represented a balance on an account which had run over a period of 10 years. After the death of George Chase, the New York Law School paid a substantial amount to the petitioner as interest on this debt.

The Board of Tax Appeals held that this was a gift, and did not represent income to the petitioner; basing its decision upon the fact that there was no obligation to pay interest, and in any event that the petitioner was not entitled to the payment of any interest.

In *Jones v. Commissioner,* 31 F. (2d) 755 (C. C. A. 3), it was held that where upon the sale of stock in two affiliated corporations by their stockholders, the stockholders deposited $300,000.00 to be distributed to the administrative staff of the two corporations, such payment was a gift, and not compensation.

The Court held that it constituted a gratuitous payment by the stockholders "in recognition of the past faithful work of the staff," and that the payment was made without obligation or any consideration then or theretofore received or rendered to the stockholders.

The Commissioner has ruled that railroad transportation passes issued to employees and their families, to be used when not engaged on business of the company, are to be considered as gifts, and not income. O. D. 946—C. B. June, 1921, p. 110, 1945 Prentice-Hall Service, par. 8676.

In the case of *Rose, Etc. v. Trust Company of Georgia,* 28 F. (2d) 767 (C. C. A. 5), it appeared that the Trust Company of Georgia was a member of a syndicate for the

purpose of reorganizing the Coca Cola Company of Georgia. The syndicate agreed to purchase 83,000 shares of the common stock at $5.00 per share and to underwrite 417,000 shares of common stock for sale to the public at $35.00 per share. The Trust Company of Georgia received 13,677 shares of common stock at $5.00 per share as a result of this transaction.

The Commissioner contended that the difference between the $5.00 per share paid and the market value of the stock, approximately $40.00 per share, constituted compensation to the Trust Company of Georgia for which it was liable for the payment of income tax.

The Court denied this contention, saying, at page 768:

> "Conceding that compensation for personal services may be paid in property, instead of in money, and that income taxes may be assessed on the value of the property, we agree with the District Court that the transaction here in question was a purchase in good faith. In such case no taxable income would be derived until the disposal of the stock, except, of course, that arising from dividends. Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. ed. 521, 9 A. L. R. 1570; McCaughn v. Ludington, 268 U. S. 106, 45 S. Ct. 423, 69 L. Ed. 868."

It has been uniformly held that where the driver of an automobile is accompanied by another individual, and the trip is made for pleasure, social or entertainment purposes, and the accompanying individual shares the cost of gasoline and oil or cost of operating the automobile on the trip, such sharing is an exchange of social amenities, and does not transform the individual from a guest into a paying passenger under statutes defining guest as a person

who accepted a ride without giving "compensation" therefor.

McCann v. Hoffman, 9 Cal. (2d) 279;
Rogers v. Vreeland, 16 Cal. (2d) 364;
Starkweather v. Hession, 23 Cal. App. (2d) 336;
Stephen v. Spaulding, 32 Cal. App. (2d) 326.

It is to be noted that the association between Lang and Morton over the period when this litigation was pending, from 1932 to 1940, was close and intimate. Morton testified that Lang was working on the case almost constantly except for a period of one year when he was in France. [64.] He testified that Mr. Lang watched the trust funds like a hawk. [68.]

These are but fragmentary revelations from which, as well as from the magnitude and nature of the litigation, the close and intimate association between Lang and Morton may be properly inferred.

It is not an uncommon experience for clients having such a long, continued association with a lawyer in regard to a matter of such importance, to present the lawyer with gifts or gratuities of one type or another from time to time, and for the lawyers to reciprocate. This is but a natural consequence of the friendship and of the social and professional relation which develops under such circumstances.

The items of interest were small and inconsequential compared with the magnitude of the work involved and the various factors, both financial and otherwise, represented by that work. It is inconceivable that so small a sum would have been paid or received as additional com-

pensation for an employment of this magnitude. It is much more reasonable and normal to infer that the interest was regarded as an inconsequential incident which Lang gratuitously permitted Hanna and Morton to take under the conditions set forth.

In addition to the foregoing, it is important to observe that interest is in reality a type of income separate and distinct from salaries, wages or compensation for personal services; and it is so recognized in the statute and by the regulations. (See Section 22, I. R. C., and Sec. 29-22(a)-1, Reg. 111).)

It is utterly inconceivable, in view of the spirit and purpose of this legislation, that Congress should have intended that the receipt of such a comparatively inconsequential amount of interest, under the circumstances here present, should deprive a taxpayer of the right to claim the benefit of this remedial legislation.

Conclusion.

As hereinbefore noted, the Petitioners are denied the benefit of Section 107, I. R. C., because the firm of Hanna and Morton in 1940 received $246.03, or 1/5 of 1%, less than 95% of the total fee.

The denial of this benefit to Petitioners would impose a shockingly heavy penalty upon Petitioners and subject them to additional tax liability aggregating $7,610.81.

The amount of this additional liability is so large, as compared with the relatively insubstantial and inconse-

quential amount of the deficit of $246.03, as to shock one's sense of fairness and justice. The results projected do great violence to the purpose and intent of Congress in enacting this legislation, and illustrate the serious consequences which may attend a too literal application of the law without regard to the spirit and purpose of the legislation. A thief who stole $246.03 would hardly be subjected to so severe a financial penalty.

Moreover, this result is achieved by treating as income amounts received prior to 1940 which were not definitely invested with the character of income at the time and could not be known to be income with certainty until 1940.

Additionally, some of these amounts, the interest items, did not constitute any part of the contracted compensation. They were, in a legal sense, purely gratuitous; and in a factual sense they were not treated by the parties as compensation, but were actually in the nature of gratuities.

There must be some sense of proportion in the administration of the law. It seems out of keeping with any sense of proportion to proceed by the theories applied in this case to classify as income "received for personal services" prior to 1940 items such as the advances from trust funds and the interest items; and thus to create the premise for holding that the income received in 1940 was $246.03 less than the amount required to entitle Petitioners to the benefit of Section 107, I. R. C., thereby sustaining a tax deficit of $7,610.81.

We respectfully urge:

(1) That the advances from the trust fund did not constitute compensation "received for personal services" prior to 1940;

(2) That the interest did not constitute such compensation received prior to 1940; and

(3) That in any event, if it be finally determined that the income received in 1940 was $246.03 less than that which would entitle Petitioners to the benefit of Section 107, I. R. C., this deficit is so insubstantial and inconsequential that the *de minimis* rule should be applied, and the Petitioners given the benefit of this section.

Respectfully submitted,

A. Calder Mackay and
Adam Y. Bennion,
Attorneys for Petitioners.